STATE OF VERMONT

HUMAN SERVICES BOARD

In re	)	Fair Hearing No. 11,216
	)	
Appeal of	)	

INTRODUCTION

The petitioner appeals the Department of Social and Rehabilitation Services' (SRS) decision to terminate her child care subsidy payments due to excess family income. The issue is whether a deduction for expenses the family took from its gross self-employment income to reach their countable income is depreciation as defined in the Department's regulations.

FINDINGS OF FACT

The facts in this matter are not in dispute. They are as follows:

1. The petitioner and her husband are both employed and have five minor children. They have received a day care subsidy through SRS for some years. In April of 1992, following a routine eligibility review, it was determined by SRS that the family's monthly income had increased to a point that was approximately $100.00 above the maximum allowed for assistance. They were notified on April 13, 1992 that their benefits would cease as of April 24, 1992.

2. SRS's decision was based on wage and income information provided by the petitioner. The petitioner herself verified that she makes $336.00 per week as a grocery

store cashier. The petitioner's husband, who is self-employed as a logger, provided the Department with an IRS form 1040 showing that he had $10,062.00 in net business income for 1991. That form is attached hereto as Exhibit No. 1.

3. Attached to the IRS form 1040 was a "Profit or Loss From Business" form, known as Schedule C. That form showed that the petitioner's husband had $30,239.00 in gross income and that $20,177.00 were listed as expenses. Among those expenses was the sum of $7,501.00 on line 13 labeled "Depreciation and section 179 expense deduction". A copy of that form is attached as Exhibit No. 2.

4. The review specialist in calculating the petitioner's husband's income determined that the $7,501.00 expense on line 13 had to be added back to his $10,062.00 net business income to determine his real income for day care subsidy eligibility because depreciation expenses are not allowed by the Department's regulations.

5. The petitioner, after consulting with her tax preparer, informed the Department that she did not believe the $7,501.00 was actually depreciation. She provided the Department with a Form 4562 labeled "Depreciation and Amortization" which had also been filed with the above IRS forms and a statement from her tax preparer. Both of these documents are attached hereto and incorporated by reference as Exhibits No. 3 and 4 respectively.

6. Exhibit No. 3 shows that the $7,501.00 represents the cost of a skidder which the petitioner listed as an expense in Part 1 of the form which part was entitled "Election to Expense Certain Tangible Property (Section 179)". Nothing was listed under the depreciation section. The worker who first reviewed the form admitted that she had never seen Part 1 filled out on that form and was confused as to what to do with it.

7. This new information was reviewed by SRS' business manager and the Commissioner who concluded that the deduction, even though taken in one lump sum, was still excludible depreciation of a capital asset. Copies of those reviews are attached hereto as Exhibits No. 5 and 6.

8. Both parties agree that if the $7,501.00 is deducted from the family's countable income they will be eligible for the day care subsidy.

ORDER

The Department's decision is reversed.

REASONS

SRS's regulations on Child Care Services (CCS) require an evaluation of the family's monthly income and comparison of that income to a maximum schedule to determine eligibility for day care services. C.S.S. ə 4034. The regulations define income as:

> The total monthly income received by a child and her/his primary caretakers which is derived from any source except for the following:

. . .

> 16. Business expenses of self-employment, (other than depreciation charges) in accordance with current IRS procedures.
>
> C.C.S. э 4031

Thus, the petitioner's self-employment income in this case may be reduced by the extent he has business expenses which are not depreciation. In its assessment, the Department has allowed the petitioner all of the business expenses he has claimed on his IRS return with the exception of the $7,501.00 he spent on a skidder. The Department's position appears to be that the purchase of capital assets in a business are always expensed through the non-allowable depreciation process. The petitioner, on the other hand, claims that the skidder has been 100% deducted as a regular 1991 out of pocket expense, not depreciated, and should be deducted from his gross income.

The Department's regulation itself does not define depreciation but rather refers to "current IRS procedures". Therefore, whether or not the $7,501.00 skidder deduction is depreciation or a regular out-of-pocket expense deduction will turn on the definitions in the Internal Revenue Code (IRC). Section 162 of the IRC allows deductions of "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business", and gives examples such as salaries, travel expenses, and rentals. Section 167 of the IRC allows as "a depreciation deduction a reasonable allowance for the exhaustion, wear

and tear (including a reasonable allowance for obsolescence) (1) of property used in the trade or business, or (2) of property held for the production of income".

Under these general code provisions, it appears that property used in a business (such as a skidder in a logging business) are ordinarily handled as "depreciation" and are subject to the accelerated cost recovery system at IRC 168. However, an exception is carved out by the code for certain business assets:

> Section 179 - Election to expense certain depreciable business assets
>
> (a) A taxpayer may elect to treat the cost of any section 179 property as an expense which is not chargeable to capital account. Any cost so treated shall be allowed as a deduction for the taxable year in which the section 179 property is placed in service.
>
> I.R.C. Sec. 179
> (Emphasis added)

That section goes on to describe the covered property as any tangible property which is purchased for use in the active conduct of a business up to a $10,000.00 amount. I.R.C. Sec. 179(a)(i).

Property which is subject to the expense election must be reported to the government on Form 4562, the same form used by the petitioner in this matter. The Treasury instructions which accompany this form describe depreciation as follows:

> Depreciation is the annual deduction allowed to recover the cost or other basis of business or income producing property with a determinable useful life of more than one year. However, land and goodwill are not depreciable.

> Depreciation starts when you first use the property in your business. It ends when you take the property out of service, deduct all your depreciable costs or other basis, or no longer use the property in your business.

That instruction goes on to explain the Section 179 expense election as follows:

> IRS Treasury Instructions Part 1 - Election to Expense Certain Tangible Property (Section 179).
>
> You may make an irrevocable election to expense part of the cost of certain tangible personal property used in your trade or business and certain other property described in Pub. 534. To do so, you must have purchased the property and placed it in service during the 1991 tax year, or have a carryover of disallowed deduction from 1990. If you elect this deduction, the amount on which you figure your depreciation or amortization deduction must be reduced by the amount of the Section 179 expense.

What Section 179 does is, at the taxpayer's election, remove from treatment as a depreciable expense up to $10,000.00 worth of what would normally be considered capital assets, and allow it to be treated as an ordinary business expense. Both the regulation and instructions make it clear that this is not just a different kind of depreciation but a procedure used instead of depreciation.

The petitioner here has elected to treat his purchase in 1991 of the $7,501.00 skidder as an ordinary expense under Section 179. The forms he filed make that clear. As the $7,501.00 is an ordinary business expense, and not depreciation, the petitioner is entitled to have that amount deducted as a business expense under Paragraph 16 of CCS э 4031 from the family's gross income used for determining their eligibility for a day care subsidy.